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JIM IRVIN
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ARIZONA CORPORATION COMMISSION 2002 MAR -8 A 10:43

AZ CORP COMMISSION
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DATE: March 8, 2002

DOCKET NOS: T-03267A-02-0120

TO ALL PARTIES:

Enclosed please find the recommendation of Administrative Law Judge Dwight D. Nodes. The recommendation has been filed in the form of an Order on:

McLEODUSA TELECOMMUNICATIONS SERVICES, INC.
(PLEDGE OF ASSETS/GUARANTY)

Applicants have waived their ten days for exceptions. Pursuant to A.A.C. R14-3-110(B), you may file exceptions to the recommendation of the Administrative Law Judge by filing an original and ten (10) copies of the exceptions with the Commission's Docket Control at the address listed below by 12:00 noon on or before:

MARCH 15, 2002

The enclosed is NOT an order of the Commission, but a recommendation of the Administrative Law Judge to the Commissioners. Consideration of this matter has tentatively been scheduled for the Open Meeting to be held on:

MARCH 19 AND 20, 2002

For more information, you may contact Docket Control at (602)542-3477 or the Hearing Division at (602)542-4250.

Arizona Corporation Commission

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BRIAN C. McNEIL
EXECUTIVE SECRETARY

1 **BEFORE THE ARIZONA CORPORATION COMMISSION**

2 WILLIAM A. MUNDELL
CHAIRMAN

3 JIM IRVIN
COMMISSIONER

4 MARC SPITZER
COMMISSIONER

5
6 IN THE MATTER OF THE APPLICATION OF
7 MCLEOD TELECOMMUNICATIONS SERVICES,
8 INC. FOR APPROVAL TO PLEDGE ASSETS
AND ISSUE A GUARANTY IN CONNECTION
WITH CERTAIN FINANCING
ARRANGEMENTS.

DOCKET NO. T-03267A-02-0120

DECISION NO. _____

ORDER

9 Open Meeting
10 March 19 and 20, 2002
Phoenix, Arizona

11 **BY THE COMMISSION:**

12 On February 15, 2002, McLeodUSA Telecommunications Services, Inc. ("McLeodUSA" or
13 "Company") filed an application with the Arizona Corporation Commission ("Commission")
14 requesting approval to encumber its Arizona assets and to issue a guaranty as part of financing
15 arrangements involving its ultimate parent company, McLeodUSA Incorporated.

16 On March 1, 2002, the Commission's Utilities Division Staff ("Staff") filed a Staff Report
17 recommending approval of the application without a hearing.

18 On March 5, 2002, the Company filed a letter waiving the ten-day period for filing
19 exceptions.

20 * * * * *

21 Having considered the entire record herein and being fully advised in the premises, the
22 Commission finds, concludes, and orders that:

23 **FINDINGS OF FACT**

24 1. McLeodUSA is an Iowa corporation and a wholly owned subsidiary of McLeodUSA
25 Holdings, Inc. which, in turn, is a wholly owned subsidiary of McLeodUSA Incorporated ("Parent
26 Company"). McLeodUSA provides integrated communications services, including local services, in
27 25 states.

28 2. The Commission originally granted McLeodUSA a Certificate of Convenience and

1 Necessity ("CC&N") for authority to provide competitive interLATA and intraLATA resold
2 interexchange telecommunications services in Decision No. 61001 (July 16, 1998). In Decision No.
3 62627 (June 9, 2000), the Commission granted the Company a CC&N to provide competitive resold
4 and facilities-based local exchange telecommunications services in Arizona.

5 3. On January 31, 2002, the Parent Company filed a voluntary petition in the United
6 States Bankruptcy Court for the District of Delaware for reorganization relief under Chapter 11 of the
7 United States Code, 11 U.S.C. §§101-1330. The Parent Company filed a pre-negotiated plan of
8 reorganization ("Reorganization Plan") in its Chapter 11 bankruptcy proceeding. The Reorganization
9 Plan is supported by the Parent Company's Board of Directors, its senior secured lenders, affiliates of
10 Forstmann Little & Co., the ad hoc committee of holders of the Parent Company's unsecured notes,
11 and certain of the Parent Company's preferred shareholders. Neither McLeodUSA nor any other
12 subsidiary of the Parent Company has filed for bankruptcy protection.

13 3. By its application in this proceeding, McLeodUSA seeks approval to pledge its assets
14 and to issue a guaranty with regard to a commitment letter entered into by the Parent Company with a
15 syndicate of financial institutions for a \$110 million revolving credit facility. The Parent Company
16 has the option to obtain additional commitments to increase the credit facility to \$160 million.
17 McLeodUSA also seeks approval to pledge its assets and to issue a guaranty with regard to \$1 billion
18 in credit facilities between the Parent Company and a syndicate of financial institutions.
19 Collectively, these "Senior Secured Credit Facilities" total \$1.16 billion. McLeodUSA requests
20 expedited consideration of its application because the Bankruptcy Court is scheduled to hold a
21 hearing on April 5, 2002 to confirm the Reorganization Plan.

22 4. McLeodUSA claims that these transactions will not affect the manner in which it
23 provides service in Arizona and, immediately following the recapitalization, the Company will
24 continue to offer the services it currently offers with no change in its rates or terms and conditions of
25 service. McLeodUSA states that it will continue to be led by the same team of experienced
26 telecommunications management.

27 5. McLeodUSA contends that approval of the transactions will serve the public interest
28 in promoting competition among telecommunications carriers. According to the Company's

1 application, the Parent Company's improved financial position resulting from the increased funding
2 will enable the Parent Company to implement its long-term growth plans and to significantly enhance
3 McLeodUSA's operational flexibility and efficiency, as well as its long-term financial viability. The
4 Company claims that the proposed transactions will directly benefit Arizona customers by ensuring
5 innovative, high quality telecommunications services to the public.

6 6. Staff recommends approval of the application without a hearing. According to the
7 Staff Report, the Parent Company's "financial distress" is typical of other "start-up"
8 telecommunications companies that have suffered financial losses in their initial years of operation.
9 Staff states that the cause of these initial losses is generally large plant investments made prior to
10 acquisition of customers, and that investors and creditors expect customer growth to generate
11 sufficient revenue to make timely debt payments. Staff believes that, in the event the Parent
12 Company defaults on its credit facilities and is forced back into bankruptcy, McLeodUSA's assets
13 would likely be useful to other telecommunications companies.

14 7. As precedent for its recommendation, Staff cites to Decision No. 64052 (September
15 18, 2001) wherein the Commission approved the encumbrance of assets of Eschelon Telecom of
16 Arizona, Inc. ("Eschelon") as part of financing arrangements involving its parent company.

17 8. In the Decision cited by Staff, the Commission specifically pointed out that Eschelon
18 was required in its initial CC&N proceeding (Decision No. 62751) to procure a performance bond
19 equal to a minimum of 120 days of intrastate revenue plus any pre-payments or deposits collected
20 from customers. However, in McLeodUSA's facilities-based CC&N case, no similar bond
21 requirement was imposed because Staff found that "McLeodUSA has sufficient financial strength to
22 offer telecommunications services in Arizona" (Decision No. 62627 at 3).

23 9. In order to ensure that McLeodUSA's customers are protected, we believe a bond
24 requirement should be imposed on McLeodUSA as a condition to permitting the encumbrance of its
25 assets as a guaranty for its Parent Company's proposed credit facilities. Therefore, we will require
26 that McLeodUSA procure a performance bond equal to a minimum of 120 days of intrastate revenue,
27 as well as the amounts of any pre-payments, advances, and deposits collected from Arizona
28 customers. The amount of the performance bond must be increased if, at any time, it would be

1 insufficient to cover 120 days of intrastate telecommunications revenue, and the cumulative total of
2 any prepayments, advances, and deposits collected from McLeodUSA's customers.

3 **CONCLUSIONS OF LAW**

4 1. McLeodUSA is a public service corporation within the meaning of Article XV of the
5 Arizona Constitution and A.R.S. §§40-281 and 40-282.

6 2. The Commission has jurisdiction over McLeodUSA and the subject matter of the
7 application.

8 3. Approval of McLeodUSA's application is in the public interest, subject to the
9 conditions described above.

10 4. Staff's recommendations in Finding of Fact No. 6, as modified by the conditions
11 described in Finding of Fact No. 9, are reasonable and should be adopted.

12 **ORDER**

13 IT IS THEREFORE ORDERED that, pursuant to A.R.S. §40-285, McLeodUSA
14 Telecommunications Services, Inc.'s application for encumbrance of its assets is granted subject to
15 the requirement that it procure a performance bond equal to 120 days of intrastate
16 telecommunications revenue, as well as any prepayments, advances, and deposits. The amount of the
17 performance bond must be increased if, at any time, it would be insufficient to cover 120 days of
18 intrastate telecommunications revenue, and the cumulative total of any prepayments, advances, and
19 deposits collected from McLeodUSA's customers.

20 IT IS FURTHER ORDERED that McLeodUSA Telecommunications Services, Inc.'s
21 encumbrance of assets approved herein shall not include or affect the assets which comprise the
22 performance bond required by this Decision.

23 ...

24 ...

25 ...

26 ...

27 ...

28 ...

IT IS FURTHER ORDERED that failure by McLeodUSA Telecommunications Services, Inc. to comply with the performance bond requirements shall render the approval granted herein null and void without further order of the Commission.

IT IS FURTHER ORDERED that this Decision shall become effective immediately.

BY ORDER OF THE ARIZONA CORPORATION COMMISSION.

CHAIRMAN

COMMISSIONER

COMMISSIONER

IN WITNESS WHEREOF, I, BRIAN C. McNEIL, Executive Secretary of the Arizona Corporation Commission, have hereunto set my hand and caused the official seal of the Commission to be affixed at the Capitol, in the City of Phoenix, this ____ day of _____, 2002.

BRIAN C. McNEIL
EXECUTIVE SECRETARY

DISSENT _

1 SERVICE LIST FOR: MCLEODUSATELECOMMUNICATIONS SERVICES, INC

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